

**A Report to the Standing Committee on Public Accounts on
Verifying the Financial Strength of Suppliers for Advance Payments**

Introduction

Public Services and Procurement Canada (PSPC), as the central purchasing agent for the Government of Canada, purchased personal protective equipment (PPE) and medical devices on behalf of federal departments and agencies as part of the Government’s response to the COVID-19 pandemic.

In May 2021, the Auditor General’s report on *Securing Personal Protective Equipment and Medical Devices* was tabled in Parliament, with recommendations directed to the Public Health Agency of Canada, Health Canada and PSPC.

Subsequently, the Standing Committee on Public Accounts studied the Auditor General’s report, and on April 6, 2022, presented its 11th report, *Securing Personal Protective Equipment and Medical Devices*, which included the following recommendation directed to PSPC:

Recommendation 4	Public Services and Procurement Canada should provide the Committee with a report explaining how its internal processes for conducting checks verify the financial strength of suppliers before awarding contracts that involve advance payment, while allowing for flexibility to address urgent needs and accepting procurement risks during crises.	Timeline: September 29, 2022
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Advance payments

Under normal circumstances, the standard method of payment in federal contracts is a payment upon delivery, completion and acceptance of all work. An alternate method of payment is advance payments, whereby payments are made prior to when the goods or services are received or prior to completion of work. Advance payments are used in federal procurement as an exception and their use is guided by a robust legal and policy framework intended to mitigate risks to the Crown.

Advance payments may be used in particular circumstances for the benefit of the Government, for example, in a contract when there is an economic advantage to the Crown outweighing the costs associated with the advance payments. Advance payments may also be considered in order to align with industry practices and/or financial situations. In some industries or segments of industries, advance payments are an entrenched tradition or practice, such as subscriptions and software maintenance and support services, which are regularly procured by PSPC. In such cases, contracts must include provisions that mitigate the risks associated with the advance payment.

In the context of the COVID-19 pandemic, without sufficient domestic manufacturing available for certain critical PPE and medical devices, PSPC had to quickly procure these goods in a highly competitive global market. Advance payments were critical to Canada being able to secure a steady supply of PPE and medical devices, as they ensured that Canada would receive these goods as quickly as possible. As a

mitigation strategy, PSPC established a dedicated team for the contract management of all COVID-19 related contracts. The role of the team was to conduct weekly outreach to suppliers in order to track pending deliveries of PPE and medical devices. Any deviation from the contract terms and conditions were reported to the assigned contracting officer and remediation measures were implemented, such as amending the contract to extend the delivery timeframe, reduce the scope, or terminate the contract, depending on the nature of the deviation.

Financial Capability Assessment of Vendors

Before awarding contracts which include an advance payment component, PSPC has a comprehensive process in place to assess the financial capability of suppliers, as well as dedicated resources available to support procurement officers in meeting their obligations in this respect.

The process is as follows:

1. The process is initiated in one of two ways; either a procurement officer requests a financial capability assessment, or a price advisor supporting the procurement identifies the need through evaluation of the risks in a supplier's proposal, including advance payments.
2. Once the process is initiated, the price advisor requests audited financial statements and notes from the supplier for a minimum of its last three fiscal years.
3. Concurrently, the price advisor obtains information from various sources including the supplier's website to gain an understanding of the supplier's background and business operations. The price advisor also uses these sources to identify financial weaknesses and potential lawsuits.
4. The price advisor uses their professional accounting expertise and judgment to analyze the supplier's requested financial data using financial capability software that calculates various key ratios and failure prediction models. This approach allows the price advisor to identify key financial risks related to the proposed contract.
5. The price advisor documents their analysis and communicates the results to the procurement officer. The price advisor is also able to provide additional support to the procurement officer when needed, such as a more comprehensive report that includes mitigation strategies to address identified risks.

Financial capability analysis is conducted as a preliminary review of a contractor's financial viability and as an overall assessment of their ability to meet the financial requirements of the contract. During the review, PSPC consults the credit score of the company to identify any financial weaknesses and potential lawsuits. Financial statements are also used to analyze various financial ratios, and failure prediction models such as Altman and Springate are part of the financial review. Other elements such as changes in governance, company structure, information available on contractors' websites, relationships with affiliates, and contractors' experience with Canada and within the industry are also considered.

To determine if a vendor has the financial capability to fulfill a contract, PSPC can ask the vendor to provide assurance (e.g., an irrevocable letter of credit, a performance guarantee).

Key measures taken to respond to the Auditor General's report

As part of its response to the Auditor General's report, PSPC committed to updating tools and processes to reflect direct experiences from the COVID-19 pandemic. Key actions to-date include:

- The distribution of a formal communiqué on November 25, 2021, to all procurement officers regarding the financial capability assessments and advance payment processes. This communiqué provided information on the steps that procurement officers must follow to fulfill their obligations with respect to mitigating procurement financial risks. The guidance and instructions included specific references to PSPC’s Supply Manual ([section 4.70.30.20 Advance Payments](#) and [section 5.60.1 Financial Capability](#)) as well as the Treasury Board of Canada Secretariat’s [Guide to Advance Payments](#).
- The development of a revised emergency procurement checklist to support procurement officers in appropriately documenting decision-making and risk mitigation strategies when awarding contracts using emergency contracting limits, whether for COVID-19 procurements or other emergency procurements that may arise. The checklist outlines items to be addressed as applicable at the various key stages of a procurement process—allocation, pre-solicitation, solicitation, evaluation and award, and contract management. Embedded links to the applicable policy guidance are available in the checklist for procurement officers’ ease of reference.
- The development of a quick-reference tool for procurement officers called the Emergency Contracting Risks Guidelines. The Guidelines provide information to procurement officers in mitigating four risks that could arise in emergency procurements, which are in close alignment to the findings in the Auditor General’s report, namely: reduced oversight and accountability; advance payments; integrity verification; and insufficient records.

Recent Procurement Activity with Advance Payments

Since the publishing of the Auditor General’s report on May 26, 2021, through to late August 2022, PSPC has awarded only five contracts with an advance payment component as part of its continuing response to the COVID-19 pandemic; these five contracts were to procure rapid tests. For each of these contracts, PSPC procurement officers obtained financial capability assessments before the contracts were awarded.

The Department has also continued with advance payments in other circumstances, where appropriate; from May 26, 2021, through to August 23, 2022, PSPC awarded 518 other contracts with an advance payment component, out of a total of 4,725 contracts awarded during that same period.

- 88% (or 457) of these contracts procured commodities for which advance payments are an entrenched practice within the industry, specifically subscriptions, and software maintenance and support.
- 11% (or 56) of these contracts were awarded under the Foreign Military Sales program, which is a mutually beneficial government-to-government method for the procurement of United States (U.S.) defence articles and services, and which requires advance payments in accordance with U.S. law. Given that these procurement agreements are entered into with U.S. government entities, financial capability assessments are not performed.
- 1% (or 6) of these contracts had an advance payment component for other commodities, and were awarded on an exceptional basis, therefore exceptional measures were taken to mitigate associated risks.